

BUSINESS FOR DEVELOPMENT: IMPLICATIONS FOR EXPORT STRATEGY-MAKERS

PALESTINE

PALESTINIAN PERSPECTIVE OF TRADE RELATED TECHNICAL ASSISTANCE

Contributed by:
- Palestine Trade Center - PalTrade

Cancún, Mexico – September 2003

I. General Background

Since the breakout of the Palestinian uprising in late September of 2000, intensified internal & external closures have placed a heavy burden on the cost & complications for movement of people and goods due to Israeli so-called "security procedures". Additionally, continuous destructive Israeli military attacks on the WBG have resulted in demolished physical assets and institutional infrastructures, which represent the life support systems for any solid Private sector development activities and therefore its economic sustainability.

Being the recipient of these blows on the political level, it is obvious that the Palestinian economy and society is fighting for its core subsistence. The latest World Bank estimates indicated by the end of 2002, the Palestinian Economic loss reached \$5.4 billion of income earning opportunities excluding physical damages to infrastructure and property. Gross National Income (GNI) declined from \$5.4 billion in 2000 to \$3.8 billion in 2002. This drastic decline is mainly a result of losses in domestic production and employment losses in the Israeli market. The overall adjusted unemployment rate increased to become 44% in 2002 as the accumulated inevitable outcome to the given political situation since the break of the Intifadah.

The impact on the Gross Domestic Product (GDP) has been on a downturn since its four year high of \$4,637 million to 3,396 million in 2002. According to the latest World Bank report, trade in year 2002 registered the record low on Palestinian exports which decreased by 24% to a total of \$260 million. Imports have also decreased by 16%.

Poverty line estimated by the National Commission for Poverty Alleviation approximated a \$2.1 in consumption expenditures per person per day in the WBG. This report also estimates that 21.1 per cent of the population fell below the poverty line by September 2000.

II. Overview of the Private sector's key sub-sectors & priority areas

At one point in time, by the year 1999 the Palestinian Private sector was the driving force for economic growth and prosperity, as per the PCSB Statistics for 1999, the Palestinian private sector consisted of some 80, 699 private sector establishments and government companies², approximately one-quarter of which are in the secondary sector (manufacturing, utilities and construction) and two-quarters in the tertiary sectors (commerce and services). 98% of these establishments were considered SMEs employing 1-20 persons.

According to the latest issue of the Economic Monitor by MAS, the largest contributors to GDP are the **Service sector** by 47% in the year 2000, the mining/Manufacturing (**industrial**) sector by 20% & the Wholesale & retail-trading sector 10%. As for employment in the West bank:

- Service sector employed 61.4% (to include wholesale/retail)
- Mining/Manufacturing sectors employed 15.5% of the labor force.

As for these two sector's employment in the Gaza Strip:

- Service sector (including wholesale/retail) employed 74% of the labor force
- Mining/Manufacturing sectors employed 7%.

Consequently, these three sectors represent the largest contributors to GDP and the largest employers of the labor force whose reliance on each other is of high level correlation and interdependence. Yet each of these sectors encompasses a number of sub-sectors who have unique needs, critical success criteria and relative national priority.

Overall Common problems

Apart from the difficulties in achieving certain direct sub-sector success factors which each industry is enduring, the current political and social ramifications have intensified the following

bottom line enterprise (micro) problems shared by majority of firms relative to the characteristics of their sub-sector in a cause and effect sequence:

- Loss of local market share due decreased market presence
- Decreased demand due to decrease in consumer disposable income as a result of rise in unemployment
- Decrease in sales volumes
- Decrease in productive capacity
- Increase in cost of production inputs
- Increase in transportation and distribution cost
- Decrease in profitability
- Decrease in financial liquidity for operational capital and payment of debts
- Decrease in product added value
- And finally inability to keep up with fast rate of international trade developments and competition heavily reliant on advanced digital technologies and communications, creativity and innovation, multi-national giants and regional enterprises' easy access to the local market

Causes of the Above Problems:

In order to effectively contribute to minimizing the negative impacts of the above problems, which typically contribute to further deterioration of the socio and economic position of the Palestinian people, the following identify the main causes of the above over all problems. Some of these causes are historical and cultural in nature and have had an accumulative effect; some are out of our scope as Private Sector Institutions except within our advocacy capacity, while others are within short-term reach and are within our scope. Additionally some causes can be dealt with on a broad cross-Sectoral level while others require sub-sector attention. The core causes in our opinion lay in the following:

- Long period of occupation which rendered the Palestinian Private Sector heavily reliant on the Israeli trade partners therefore limiting its capacity to move away and diversify its products and services
- Infancy of the PNA as a governing body and its weak capacity to set and implement long-term economic development strategy that is based on a national export strategy for goods & services since its inception in 1994 after the Oslo Accords
 - Loss of opportunity for an effective trade related technical assistance program from preceding donor aid due to corruption, lack of prioritization and inefficiency.
 - Unclear trade transaction cost & procedures for the majority of firms by the PNA internal administrative process & irregular Israeli security practices
 - Weak regulatory and legislative systems in support of an enabling business environment
 - Access to reliable infrastructure is complex, inconsistent and costly
 - Access to long-term financing, export financing and operational financing is too costly, complex, time consuming and high collateral requirements
 - Lack of specialization and innovation due to a generally weak human resource base resulting from outdated educational curriculums & vocational training centers
- Impact of the Israeli movement restrictions within the past three years of Intifadah limiting market access
 - Israeli security pre-cautions
- The re-shuffling and changes within the PNA and the political reform process.
 - Limited trust in the government
 - Instability of the internal threads holding the society together

- Accumulation of internal enterprise inefficiency, distress, frustration & a reactive mode of operation. In short WEAK COMPETITIVE POSITION due to inability to quickly respond to dynamic market changes
 - Family business structure: informal and weak documentation in management and financial systems as a result of non-existence of a corporate culture
 - Low rate of higher educational outputs in decision making positions
 - Flat management structures: lack of availability of mid-level managerial positions
 - Low financial liquidity due to lengthy payment terms as an element pre-requisite to competition
 - Limited access to advanced and specialized training centers and low priority and financial resources available for human resource development by companies.

The most recent draft of World Bank report “A Strategy for Private Sector Development in the West Bank & Gaza: From Crisis to Sustainable Growth” the following broad facts were reaffirmed again regarding the Private Sector status:

- High cost of scarce production inputs (labor, land, electricity, water, transportation & raw materials) due to heavy dependency on Israel resulting in high incremental added cost burden placing Palestinian products and services at a competitive disadvantage
- Insufficient Private sector capacity to insure high & uniform product quality
- Rise of cash flow concerns

The fast rate of market liberalization and their consequent globalization simply means that in addition to the above problems and given the built in deficiencies and complexities in the resolution of some core causes, Palestinian firms have an even more complex task in facing stiffer competition inside Palestine and the international market place than any other country.

As such, Palestinian enterprises will have to adjust in order to become globally competitive. In their active pursuit of new commercial opportunities, enterprises must carry out fundamental redefinitions of the way they conduct business or continue facing the inevitability of diminishing sales and profits as they have been for the past years on their own.

Even though the responsibility to change rest on the enterprise, within the Palestinian context and as analyzed above, Private sector institutions must take the lead in assisting the restructuring and upgrading of their own sectors and enterprises, the PNA and the donor community must assume the role of facilitators in supporting such a change for fulfilling a National agenda and for truly making a return on the donors support.

III. Private Sector position vs. Palestinian Development Plan & trends in Donor support

In addition to the long period of occupation which rendered the Palestinian Private Sector heavily reliant on the Israeli trade partners therefore limiting its capacity to move away and diversify its products and services, the impact of the Israeli movement restrictions within the past three years of Intifadah has added on to the burdens of the Palestinian Private sectors competitive position on all levels as stated above.

Having said that, the Palestinian Ministry of Foreign Affairs in their June 2003 monitoring report of Donors' Assistance states in general terms the priority sectors of the Palestinian Development Plan (PDP) to be 1-Infrastructure & Natural resources, 2 Institutional Capacity Building, 3- Human resources and Social Development, and finally 4- Productive sectors.

So, of the total committed donor funds from 1994-1st quarter of 2003 (\$6,708,240,000) as detailed in Annex 1, productive sector development funds equaled 11% (\$764,402,000), of which 53% was dispersed and only 9% was utilized. Specific private sector (industrial, service, trade) committed funds for the same period were \$105,919,000 which represent 1.6% of the overall

committed funds (\$6,708,240,000) while disbursements were \$51,600,000 for the period from 1994-1st quarter of 2003.

As such the key contributors to GDP have not truly gained much from the past donor support due to the small amount of funds \$51,600,000 (1.6%) of the total donor aid. In addition, these funds have been fragmented into more than 95 different projects (documented) and initiatives fulfilling diverse objectives and without any strategic linkages between any of them falling under a unified and clear national agenda. Yet the value of these initiatives is not the key problem, the more important issue is the fragmentation and unclear prioritization of the PNA.

Needless to say, the same report states that donor disbursement of funds has improved in 2001 to 81% due to the Palestinian economic losses witnessed, however a large portion of this aid has been directed towards humanitarian aid, emergency employment and financing the Palestinian Authority's current budget leaving out the productive sectors of the economy to face its destiny alone.

As such, if Palestine were to achieve economic sustainability and growth, the secret ingredient would be in the re-direction of the PNA and the donor communities' priority sectors by providing support to the productive sectors of the economy more specifically in the fields of international trade in goods and services through a realistic trade and export development strategy utilizing donor funds in an integrated Trade related technical assistance program.

In the Palestinian context, the PNA has not been able to establish or maintain such a program due to:

1. Uncontrollable Israeli destructive practices
2. PDP's choice of priority sectors and consequently donor communities' reliance on the PDP as the directive for their support programs
3. PNA and donor community's focus on resolving short-term survival and crisis needs
4. Internal Institutional deficiencies within the PNA due to lack of transparency in the legal and regulatory framework and administrative inefficiencies

This re-iterates the problem of both the PNA & the donor communities in undermining the importance of the Private sector a driver for economic sustainability. As such the Palestinian economy has entered a vicious cycle for survival and will continue to be in this viscous cycle if both parties do not break away by leading and adjusting their priorities to the long-term private sector trade and export development needs captured above through the materialization of a realistic and coherent National trade development strategy. Annex 2 provides brief description of the diverse private sector initiatives that should indicate the direction of the PNA and the donor community.

IV. Areas for Support

Accordingly, the Palestinian Private sector is determined and is well aware that in order to overcome this short-term crisis, there must be support provided to it by the PNA and the donor community in order to develop its competitive capacity and not merely survive the current "crisis" through dedicating financial and technical resources to the productive sectors of the economy:

As such key areas that the private sector foresees as short to medium term crisis yet strategic development needs given the degree and rate of political complications and developments include the following:

1. A comprehensive and transparent legal and regulatory framework for firms
It is fundamental for firms that a comprehensive and transparent legal and regulatory framework is present within the PNA in order to negate the influences of the political instabilities and provide for a predictable macroeconomic environment. Even though

the PNA is devoting considerable efforts on that regard, Private sector is eager to see more of these efforts being put in the following directions:

- Harmonization of the laws and regulations to minimize confusion and unclear interpretations of the legal hierarchy.
- The need to strike the balance between legitimate time, effort and institutional capacity needed to complement the regulatory framework to insure various components of the economic regime are harmonious and support a comprehensive vision for the nature of the Palestinian economic & trade regime.
- Legislation must also be based on sound macroeconomic and Sectoral surveys which in order to be effective must be conducted in thorough and timely manner.
- Introduction and support for alternative dispute resolution mechanisms for facilitating the settlements of legal disputes parallel to completing and enforcing civil justice system.

2. Trade Facilitation

Harmonization and simplification of procedures affecting the flow of goods and services is also key to the competitive position of enterprises yet as complex as this matter maybe given the political and security restrictions of the Israeli government, many aspects of trade facilitation in the Palestinian context are meant at this point on an internal level.

- Transparency and predictability of related PNA bodies in the administrative procedures for imports and exports by creating and managing a hotline for receiving complaints and identifying obstacles faced by companies from public sector agencies involved in trade facilitation
- Public sector key trade facilitation units and private sector logistics service providers coordination and provision of consistent information regarding trade related laws, regulations, administrative guidelines to be distributed to all key stakeholders in the trade community.

3. Improving public-public dialogue and public-private coordination

This area is critical for insuring policy & procedural consistency and enhancing efficiency in the provision of public services. Further more, insuring effective public-private coordination is also of paramount importance to reflect private sector interest in public policy procedures for enhancing accountability and procedural inefficiencies.

- Supporting the institutionalization of an effective public – private sector dialogue re-enforces national economic benefits fit with private sector capacity and ability to meet challenges of international trade policy commitments such as WTO accession and optimizes market access benefits from such commitments.

4. Assisting in the recovery and improved competitiveness of dynamic firms

This is both a public and private sector institutions' duty that must commence with donor support immediately and shall not be contingent upon improvements in the political arena.

In the case of the Palestinian Private sector, competitiveness is the product of a multiplicity of factors. As such factors of the value chain begin with efficient raw materials procurement; management; processing and production procedures, via packaging, transport packing, distribution, and marketing and finally export logistics all determine enterprise competitiveness. All such elements vary greatly between one sector and another, between the numbers of sub sectors within each sector let alone the varieties of enterprises. Accordingly,

- Private sector institutions are key to the achievement of enterprise competitiveness in that each within its own scope of work & specialization

should become the authoritative starting point for counseling and directing its member firms by providing technological support for sector quality management, productivity improvements, metrology and technical services for SMEs based on international best practices within each sub sector of the related manufacturing and service sectors. As such and in order for these institutions to be effective in their pursuit, donor & PNA support must be provided to sustain, restructure and build institutional capacity in order to deliver the needed enterprise services.

- Sustained investment in human capital at all levels especially scientific, information technology, and engineering. Increased enterprise training & technical assistance through specialized and key private sector institutions in sector specific technical know-how, export training & counseling.
- Additionally, donor support must be in the form of direct assistance to enterprises to restructure in order to meet the challenges of the latest political circumstance of destruction to the physical infrastructure and private assets, as well as the lost opportunities resulting from the closure policy. Additionally, restructuring is imperative to prepare for meeting the anticipated challenge of trade liberalization. Such restructuring will insure effective firm level management of backward and forward linkages simultaneously with high levels of operational efficiency in internal processes crowned with innovative strategic capacity to respond to dynamic market trends.

5. Financial Support to firms:

Access to financial facilities is vital for the private sector to maintain a sustainable level of operation. The existing risk-sharing schemes and financial service provisions through local banks are ineffective particularly because banks are discouraged to lend given the low repayment rates therefore denying firms' access to financial support. As such, donor provision of risk guarantee funds to banks will compensate for risk of defaulting due political circumstances.

- Credit facilities such as long-term financing for up-grading technologies, enhancing quality and to minimize production cost advances enterprise competitive positions.
- Pre-shipment export credit and guarantees is highly needed for minimizing the financial load of firms to purchase raw materials for export.
- Supplier credit is yet another financial support tool to make up for the deferred payments that importers impose on suppliers. This will allow for better negotiating leverage of the Palestinian exporter and will provide liquidity to sustain operations.
- Post-shipment export credit guarantee against commercial / political risk will further bridge the gap for Palestinian firms to take active role in export activities

In conclusion, what the Palestinian Private Sector is seeking is PNA, Arab and international donor communities' support within a integrated National Trade Development strategy to enhance overall economic sustainability and growth through the above priority areas and future programs to the productive sectors of the economy more specifically the industrial & service sectors.

Annex 1: Donor Commitments & Disbursements Charts by sector: 1994 - 1st Q 2003

